



EFFECT OF TAX INCENTIVES ON THE GROWTH AND DEVELOPMENT OF MANUFACTURING FIRMS IN NIGERIA

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ABSTRACT: *The study examined the effect of tax incentives on the growth and development of Manufacturing firms in Nigeria. The study employed ex-post facto research design. Data on corporate income tax incentives, capital allowance incentives, custom duty incentives, excise tax incentives and return on asset were secondarily sourced from financial statement of account from 2013 to 2018. The data were analysed using ordinary least square of multiple regression technique through E-view 9.0. Based on the analysis of the study, the results revealed that corporate income tax incentives ($P = 0.00 < 0.05$) has positive and significant effect on return on asset; capital allowance incentives ($P = 0.00 < 0.05$) has positive and significant effect on return on asset; custom duty incentives ($P = 0.00 < 0.05$) has positive and significant effect on return on asset, excise tax incentives ($P = 0.00 < 0.05$) has positive and significant effect on return on asset in Nigeria. The study concluded from findings of the study that tax incentives on the growth and development of Manufacturing firms in Nigeria. The study recommended the need for the government to conduct cost benefit analyses in order to ensure that the goals of granting such incentives are achieved.*

KEYWORDS: Tax Incentives, Growth, Development, Manufacturing Firms, Nigeria

INTRODUCTION

Industrialization culminates from the sustenance of the productivity of firms over a period. It implies the value addition on factor input and its efficiency, where additional input should yield more firm output. It is expected that with increasing industrialization, the cumulative effect be seen in the creation of jobs for sustained growth and economic diversification. More so, industrialization brings about increased household consumption through improvement in the value of product and price efficiency, and the development of other primary sectors through backward linkages that come with the demand for intermediate goods (Rapuluchukwu, Belmondo & Ibukun, 2015). Despite these identified benefits, most African countries have relied heavily on primary products as their main export commodity (UNECA, 2013) and the productivity of other sectors (apart from the primary sector i.e. agriculture) such as the manufacturing sector have remained a source of concern to both the policy and research community.



Many large manufacturing firms have relocated or restructured their operations, opting to serve the local market through importing from low-cost manufacturing areas such as Egypt therefore resulting in job losses (Nyabiage & Kapchanga, 2014) citing turbulent operating environment and high operating costs. This is an indication that many manufacturing firms in Nigeria are experiencing performance challenges with many reporting profit warnings due to challenges in the operating environment (Abdulrahman & Kabir, 2017). One of the key drivers of the high cost of doing business facing manufacturing industries thereby impeding its development was the problem of excessive taxation in the form of high tax rate, double and multiple taxation (Uwalomwa, Ranti, Kingsley & Chinenye 2016).

Hence, to mitigate this challenge, the government had advanced various tax incentives to the manufacturing sector. According to Uwalomwa, Ranti, Kingsley and Chinenye (2016), some of the problems faced by manufacturing industries include difficult and unfavorable operating environment due to infrastructural deficiency and unavailability of fund to finance capital projects like expansion. Although taxation forms one of the major sources of government, it may affect manufacturing firms negatively if not properly applied and administered. Thus, higher tax rates serve as disincentive to firms for investment and expansion as it leaves firms with less money to reinvest. This eventually discourages productivity, investment and the level of output by the manufacturing industry.

According to Fletcher (2013), tax incentives are those special exclusions, exemptions, or deductions that provide special credits, preferential tax rates or deferral of tax liability. Tax incentives can take the form of tax holidays, investment allowances and tax credits, accelerated depreciation, special zones, investment subsidies, tax exemptions, reduction in tax rates and indirect tax incentives. Hence, tax incentives can be defined as fiscal measures that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country. Agundu (2012) opined that tax incentives are widely used by governments around the world to attract private investment in preferred industries, including tourism. Incentives are often granted to offset actual or perceived differences in the cost of doing business in different political jurisdictions whether the cost differences arise from tax differences or from differences in transportation, labour, or other costs (Peters & Kiabel, 2015). This acts as a catalyst for improved performance (Philips, 2010). Incentives raise the return to capital thereby making investment in a location more attractive and in turn increase profitability of the firm.

In Nigeria, the government has put incentives in key sectors like manufacturing sector. Export Processing Zones (EPZ), for instance, are big beneficiaries of the incentives. Numerous tax incentives are provided in Nigeria's EPZs, the most significant of which are: 10 year corporate income tax holiday, followed by a 25% rate compared to the standard 30% for the next 10 years and 10 year exemption from all withholding taxes, exemption from import duties on machinery, raw materials, and inputs (Network-Africa, & Action Aid International, 2016). On the same hand, inputs such as raw materials, machinery, and office equipment, certain petroleum fuel for boilers and generators and building materials also get perpetual exemption from VAT and customs import duty. According to World Bank (2015), capital investment allowances have also been offered to those investing in capital projects on a reducing balance. They include industrial building allowances which is granted on capital expenditure incurred on the construction of an industrial building, investment deduction which is granted to encourage development in manufacturing industries and shipping investment deductions granted at a 40 percent on capital expenditure and only one such



deduction can be allowed in respect of the same ship. However, despite the various tax incentives being made towards these firms, the effects on their performances have not been producing significant result.

Generally, the manufacturing sectors' average growth percentage has continued to stagnate at three to four percent over the years. Peters and Kiabel (2015) conducted a study on the effect of tax incentives on foreign direct investments (FDI) in Nigeria but did not focus on financial performance. Hence, this study seeks to fill this gap by examining tax incentives and their influence on performance of selected manufacturing firms in Nigeria. In another study researched by Uwaoma and Ordu (2016) on tax incentive and economic development of Nigeria, a research gap was found as the study failed to studied manufacturing firms as if manufacturing firm is not part of the real sector, therefore this study will mainly look into the growth and development of manufacturing sector in Nigeria. A research gap was also depicted in the studies conducted by Abdulrahman and Kabir (2017) examined tax incentive as a real modifier for industrial growth and development in Nigeria, the study revealed a methodological gap since it employed descriptive statistics while the current study will focus on the manufacturing firms by employing inferential statistics. Furthermore, Tapang, Onodi and Amaraihu (2018) evaluated the effect of tax incentives on foreign direct investment in the petroleum industry in Nigeria without considering manufacturing sector as if it is only FDI that can derive benefit of tax incentive; therefore, this study will seek further on manufacturing sector.

Asides, the aforementioned studies in Nigeria, not many studies have been investigated on tax incentives and growth of manufacturing firms in Nigeria. The studies carried out by Ocheni (2015), Oladele and Agbaje (2016), Adefeso (2018) analysed the impact of tax policy on SMEs and manufacturing firms respectively. This indicates that there are sparse of review on tax incentives and growth and development of manufacturing sector in Nigeria. Evidence from the review so far disclosed that most of the studies have been on corporate tax incentives and capital allowance incentives with less focus on excise and custom duty incentives even though they had been found to influence the performance of corporate. The review showed that the direct link of tax incentives to performance of firms had not been conducted in depth and only general discussions of tax had been given. The review also showed that the link between tax incentives and performance of firms majorly in the manufacturing sector had not been studied in depth in Nigeria and much had been done in other countries such as Kenya and Ghana. Hence, this study will fill these research gaps by assessing tax incentives and their influence on growth and development of manufacturing firms in Nigeria; determine the effect of corporate income tax incentives, capital allowance incentives, custom duty incentives and excise tax incentives on performance of selected manufacturing firms in Nigeria.

LITERATURE REVIEW

According to Fletcher (2013), tax incentives are those special exclusions, exemptions, or deductions that provide special credits, preferential tax rates or deferral of tax liability. Tax incentives can take the form of tax holidays, investment allowances and tax credits, accelerated depreciation, special zones, investment subsidies, tax exemptions, reduction in tax rates and indirect tax incentives. Hence, tax incentives can be defined as fiscal measures



that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country.

Ifueko (2009) describes tax incentive as special arrangement in tax laws to: stimulate growth in specific areas, attract, retain or increase investment in a particular sector, assist companies or individuals carrying on identified activities. Tax incentives are monetary measures that are utilized to draw in home or oversee investments to certain financial exercises or specific regions in a nation. Tax incentives may take different structures. Pertinent tax incentives include, exemption from paying tax for some few years after start up, allowances for investments related expenses, tax credits, accelerated devaluation policies, unique zones, subsidized investments, tax exemptions, decreased rates of taxation and indirect tax incentives (Easson & Zolit, 2013).

In literature, optimal tax theory (Frank Ramsey, 1927); normative theory (Fletcher, 2003); taxes in the theory of investment behaviour (Robert & Ben, 2001); agency theory of tax incentive (Wells, 2001), and cluster approach theory (Porter, 1990) have been widely used to determine the nexus between tax incentive and development of firms. The theory of investment behaviour stipulates that there is ambiguity surrounding the net impact on job creation where tax breaks exist and there is an inverse relationship between investment changes and the resulting labour intensity. Hall and Jorgenson (1967) provide a solution by advocating for a reduction in uncertainty by creating a suitable policy management as well as ensuring there is political stability.

Manufacturing firms are monitored by the government as they provide tax incentives for their production activities which therefore explain the rationale behind incorporating this theory into this study. The legitimacy of government belief that horizontal equity in government taxation as well as expenditure is not justified since it may not fully address policy objectives even if they do address part of characteristic market failures in other sectors (Allen & Morisset, 2001). The policy therefore advocates a number of issues that need to be addressed in order to justify any government incentives. For instance, the government should focus its incentives to specific areas that are receiving less investment than they should as information asymmetry can alter economic fundamentals.

In an empirical review researched by Mayende (2013) on analysis of tax incentives and performance of Ugandan manufacturing firms in terms of gross sales and value-added employing panel data estimation techniques. The study findings show that firms with tax incentives perform better in terms of gross sales and value added than their counterparts. The education level of managers of firms, firm-size, and age of the firm have positive impact on firm performance. Peters and Kiabel (2015) employed a model of multiple regressions using static Error Correction Modelling (ECM) to determine the time series properties of tax incentives captured by annual tax revenue as a percentage of Gross Domestic Product (GDP) and FDI. The result showed that FDI response to tax incentives is negatively significant, that is, increase in tax incentives does not bring about a corresponding increase in FDI.

In a similar study in Nigeria, Ocheni (2015) applied questionnaire as a source of data to evaluate the impact analysis of tax policy and the performance of small and medium scale enterprises. The study indicates that there is no significant difference in the mean opinion scores of managers and accountants on the best tax policy that encourages tax compliance by SMEs in Nigeria. It was however concluded in the study of Umaoma and Ordu (2016) that



sufficient tax incentives enhance industrial growth and economy. Olaleye, Riro, and Memba (2016) examined the effect of company income tax incentives on performance of listed Nigerian manufacturing companies and concluded a strong positive linear relationship between reduced company income tax incentives and foreign direct investment. Rotimi and Agbaje (2017) examined the impact of corporate taxes on performance of selected companies quoted on the Nigerian Stock Exchange (NSE) in Nigeria. Finding showed existence of positive nexus between corporate tax and performance of manufacturing companies in Nigeria.

Abdulrahman and Kiabel (2017) employed the analysis of Chi-square to determine the effectiveness of tax incentives in developing the Nigerian economy and the extent to which individuals and companies have been responding to the incentive scheme, and how these incentives have been stimulating and motivating these bodies on employment opportunities. It was discovered that the tax incentives granted were inadequate to sustain the desired development for which it was granted. Aladejebi (2018) investigated the degree of tax compliance among owners of small and medium enterprises (SMEs) in Nigeria. Finding showed that female SME owners are more tax compliant than male counterparts. In a cross-country study on contribution of tax incentives towards FDI inflow into Nigeria, Ghana and South Africa by Ugwu (2018), it was discovered that there is a positive association between tax incentives and FDI and that FDI had no significant effect on the exports of Nigeria, Ghana and South Africa. Ngure (2018) assessed tax incentives and their effect on the performance of selected manufacturing firms in Kenya. The study findings revealed that corporate income tax, capital allowance incentives, custom duty incentives and excise tax incentives have direct and significant effect on the performance of the firms. Tapang, Onodi and Amaraihu (2018) focused on the effect of tax incentives on foreign direct investment in the petroleum industry in Nigeria. The findings revealed that tax incentives proxy by investment tax allowance, non-productive rent, capital allowance has a significant effect on foreign direct investment.

Adefeso (2018) examined the influence of government corporate tax policy on the performance of 54 randomly selected listed companies that cut across 17 categories of non-financial in Nigeria over a period of 1990-2002. Using Generalised Method of Moment (GMM) and contrary to the expectation, the study found positive relationship between corporate tax policy and the output performance of quoted manufacturing firms in Nigeria. Twesige and Gasheja (2019) analysed the effect of tax incentive on the growth of small and medium-sized enterprises (SMEs) in Rwanda taking SMEs in Nyarugenge as a case study. The study concluded that tax incentives are the key to the sustainable growth of SMEs.

METHODOLOGY

This study adopts ex-post factor research design. This type of research design does not give room for data manipulation or alteration rather it categorically deals the exact figures and data as they appear on financial statement of accounts. There are over 200 quoted manufacturing companies under the floor of NSE in Nigeria. Nonetheless, this study selected only 3 firms that have been in business over the past ten years and are duly registered with NSE namely; Dangote cement Plc, Lafarge Plc and Guinness Nig. PLc. The study covered the period of 2015-2019.



The model adopted in the study is in alignment with Ngure (2018) on tax revenue and performance of manufacturing firms. Thus, the model is stated as:

$$ROA = f(CIT, CAI, CDI, ETI) \text{ ----- } 1$$

Where:

ROA = Return on asset (Performance variable)

CIT = Corporate income tax incentives

CAI = Capital allowance incentives

CDI = Custom duty incentives

ETI = Excise tax incentives

The data for this study is time series annual secondary data. As such, the data was sourced from annual publication of respective manufacturing firms in Nigeria.

RESULT AND DISCUSSIONS

Presentation of Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.968025	0.389754	7.615119	0.0000
CIT	1.187348	0.119723	9.917437	0.0000
CAI	0.115741	0.037856	3.057434	0.0060
CDI	0.438232	0.122768	3.569595	0.0018
ETI	4.500714	1.199306	3.752766	0.0002
R-squared	0.954847	F-statistic		148.0280
Adjusted R-squared	0.948396	Prob(F-statistic)		0.000000
Durbin-Watson stat	1.660668			

Source: Author's Computation (2020), E-view 9.0 version

The relationship between the dependent variable (return on asset) and the explanatory variables of corporate income tax incentives, capital allowance incentives, custom duty incentives and excise tax incentives in the table 4.1 can be expressed mathematically as:

$$ROA = 2.968025 + 1.187348CIT + 0.115741 CAI + 0.438232 CDI + 4.500714ETI + \mu$$

The result in table 4.1 disclosed that the dependent variable have propensity to increase positively all things being equal, that is if all the explanatory variables were held constant, the federal government revenue generation will spur up manufacturing firms to greater days. Corporate income tax incentive (CIT) is positive and significantly related to return on asset of Manufacturing firms in Nigeria under the study period. This implies that an increase in



corporate income tax incentives will lead to an increase in return on asset by 1.187348 units. Capital allowance incentives is also positive and significantly related to ROA, by implication, capital allowance incentive will increase return on asset of firms by 0.115741. Custom duties incentive also revealed a significant positive relationship with return on asset in Nigeria, thus a unit change in the level of custom duty incentives will cause an increase of about 0.438232 in return on asset in Nigeria. Finally, excise tax incentive is significant and positively related with return on asset of manufacturing firms in Nigeria under the study period. This implies that a unit change in the level of excise tax incentives will cause an increase of about 4.500714 in return on asset of manufacturing firms in Nigeria. The Durbin Watson Statistics of 1.660668 is not significantly difference from 2 by approximation. Hence, the study concluded that there is presence of no autocorrelation in the study.

CONCLUSION

The main purpose of this study was to assess tax incentives and their influence on performance in selected manufacturing firms in Nigeria. Based on the study findings, the study concluded that corporate income tax incentives had a positive and significant effect on the performance of selected manufacturing firms in Nigeria. The study also concluded that corporate income tax incentives had the largest effect on performance compared to other tax incentives. Similarly, the study concluded that capital allowance incentives and custom duty incentives affected the performance of selected manufacturing firms in Nigeria positively. Excise tax incentives were also found to influence the performance of selected manufacturing firms in Nigeria positively. Based on the study findings, it was concluded that tax incentives channeled by the government to the manufacturing firms in Nigeria affected the performance of the manufacturing industry and could be used to enable expansion and survival of firms in these sectors. The finding from the study is in consistence with Ngure (2018). The study also suggested the need for government to conduct cost benefit analyses in order to ensure that the goals of granting such incentives are achieved, also recommended the need for reducing the variability in the amount of incentives among the firms so as to ensure the survival of a greater number of firms.

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